

Letter of Findings Number: 04-20100450
Use Tax
For Tax Years 2007 and 2008

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ISSUE

I. Use Tax—Equipment.

Authority: IC § 6-8.1-5-1(c); IC § 6-2.5-5-40; Sales Tax Information Bulletin 75 (October 2008), 20081029 Ind. Reg. 045080815NRA; Indiana Dep't of State Revenue v. Interstate Warehousing, 783 N.E.2d 248, 250 (Ind. 2003); IC § 6-2.5-2-1; IC § 6-2.5-3-2.

Taxpayer protests the assessment of use tax for various equipment.

STATEMENT OF FACTS

Taxpayer is an Indiana company. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit for the tax years 2007 and 2008. As a result of the audit, the Department issued proposed assessments for use tax and interest. The Audit Report states that Taxpayer "is a service company providing warehouse space for medical products of other companies" and that Taxpayer "does not own the [] products." The Audit Report states:

[T]he products are tested upon arrival for integrity and the customer may ask that they be tested again periodically for various reasons such as stability and shelf life. [] products are stored, for instance if in a clinical trial, where the patient information is maintained relating to the [product].

Further, the Audit Report states:

Equipment used to store products in the warehouse is not being used to conduct qualified testing and research under Indiana Code 6-2.5-5-40 and Sales Tax Information Bulletin #75. Even though some qualified research testing is performed on some items, the purchases taxed in this audit are used to provide storage for customer owned products, and are taxable.

Taxpayer states that it is "a contract service provider in the global [] research and development and clinical trials industries." Taxpayer protested in its July 27, 2010, letter "that the assets in question" were research and development equipment under IC § 6-2.5-5-40. An administrative hearing was conducted and this Letter of Findings ("LOF") results. Further facts will be supplied as required.

I. Use Tax—Equipment.

DISCUSSION

At the outset, the Department notes that under IC § 6-8.1-5-1(c): "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." The Department also notes that the rules of statutory construction require that exemption statutes be strictly construed against the Taxpayer. Indiana Dep't of State Revenue v. Interstate Warehousing, 783 N.E.2d 248, 250 (Ind. 2003).

Pursuant to the Indiana code, a sales tax ("gross retail tax") is imposed on retail transactions made in Indiana unless a valid exemption is applicable. IC § 6-2.5-2-1; IC § 6-2.5-5-1 et seq. Also, a complementary excise tax "known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a).

Taxpayer argues it is entitled to the research and development exemption set out in IC § 6-2.5-5-40 on several of the items. That exemption provides a sales tax exemption "for research and development equipment purchased after June 30, 2007." Sales Tax Information Bulletin 75 (October 2008), 20081029 Ind. Reg. 045080815NRA.

IC § 6-2.5-5-40 states as follows:

(a) As used in this chapter, "research and development activities" does not include any of the following:

- (1) Efficiency surveys.
- (2) Management studies.
- (3) Consumer surveys.
- (4) Economic surveys.
- (5) Advertising or promotions.
- (6) Research in connection with literary, historical, or similar projects.
- (7) Testing for purposes of quality control.

(b) As used in this section, "research and development equipment" means tangible personal property that:

- (1) consists of or is a combination of:
 - (A) laboratory equipment;

- (B) computers;
 - (C) computer software;
 - (D) telecommunications equipment; or
 - (E) testing equipment;
 - (2) has not previously been used in Indiana for any purpose; and
 - (3) is acquired by the purchaser for the purpose of research and development activities devoted directly to experimental or laboratory research and development for:
 - (A) new products;
 - (B) new uses of existing products; or
 - (C) improving or testing existing products.
 - (c) A retail transaction:
 - (1) involving research and development equipment; and
 - (2) occurring after June 30, 2007; is exempt from the state gross retail tax.
- (Emphasis added).

The Department's position on how this statute is to be interpreted is set out in Sales Tax Information Bulletin 75 (October 2008), which states:

Research and development equipment means tangible personal property that consists of laboratory equipment, computers, computer software, telecommunications equipment, or testing equipment that has not previously been used in Indiana for any purpose and is acquired by the purchaser and devoted directly to experimental or laboratory research and development for new products, new uses of existing products, or improving or testing existing products.

Research and development equipment does not include hand powered tools or property with a useful life of less than one year.

(Emphasis added; See also Sales Tax Information Bulletin 75 (September 2007), 20071003 Ind. Reg. 045070635NRA).

Taxpayer states in correspondence to the Department:

At the heart of this examination [audit] is a misunderstanding of the unique construction of the [Taxpayer's] building—barring the administrative space—as it is designed to achieve a fully-controlled, climatic environment that functions as an extension of the laboratory. The building's design and equipment facilitate the management of varying controlled environments within certain defined areas within the structure that are absolutely critical to the clinical testing and trials that are continually conducted throughout. The building is constructed to function no differently than any of the coolers or freezers housed within the building and would be correctly viewed as extensions of those units (in fact, the structure serves to take the place of the many individual coolers and freezers that would be required without its unique design).

Taxpayer also states:

[T]he critical function of the various controlled environments within the building cannot be achieved, maintained and actively managed as required without the use of the specifically-constructed scaffolding which organizes the lab and testing materials held throughout the structure, along with the numerous relative humidity and temperature sensors located as a component of the scaffolding among the lab and testing materials. This design is what allows the environmental chambers to function as an extension of the laboratory, and is a key facilitator in the required, continual testing of such materials.

Taxpayer protests that the following specific items are exempt: (1) a walk in freezer; (2) pallet and shelf scaffolding; (3) "[t]emperature/humidity tracking and trending hardware"; and (4) "[s]cale conversion...." This LOF will now address those items.

(1) Walk in Freezer:

The Audit Report stated that the "walk in freezer" was taxable since it was used to provide storage. Taxpayer, on the other hand, argues that "[s]ome materials maintained in this freezer must remain within a very specific temperature range as dictated by the client for various reasons and is required by the temperature/excursion testing they have conducted prior." (Emphasis added). Additionally, Taxpayer states:

Whether the materials are used in conjunction with lab work, material testing, material maintenance, degradation prevention, or whether [Taxpayer] becomes an extension of the dispensation chain of the client, they must remain controlled at this specific temperature as they continue their processing through to the final drug product.

Taxpayer also argues that:

[M]any clients request temperature deviations for the products. These temperature and maintenance deviations are used in degradation testing for the different materials. The products are cycled through many different temperature/humidity states and then are tested throughout these deviations to determine how the differences impact the product. Some of the studies using this process are called temperature excursion and thermal cycling stability studies. These are a couple of the multiple tests that can be performed for clients using the walk-in freezer R & E equipment.

(Emphasis added).

From Taxpayer's description above, the freezer is used for "temperature excursion and thermal cycling stability studies," but it also appears to be used for other purposes (for example, Taxpayer in correspondence states "Some materials maintained in this freezer...."). Taxpayer's protest is sustained subject to Audit verification of the following: that the freezer has not previously been used in Indiana for any purpose; and subject to Audit verification of the percentage that the freezer is used for "temperature excursion and thermal cycling stability studies."

(2) Pallet and Shelf Scaffolding:

Regarding this issue, Taxpayer states that:

[Taxpayer] has built an extensive system within the facility of environmental chambers on a large scale and in a small scale within the coolers and freezers to test maintain [sic] the product in a safe manner and most importantly to allow for effective and even air flow around the product to help maintain equal, constant and proper storage temperatures and humidity levels. Not all products can be tested at once nor can all products be tested within a seemingly 'normal' amount of time.

Taxpayer also argues that the "various controlled environments within the building cannot be achieved, maintained and actively managed... without the use of the specifically-constructed scaffolding which organizes the lab and testing materials...."

The Audit Report denied the scaffolding, referring to it as shelving. As noted, under IC § 6-8.1-5-1(c) the taxpayer bears the burden of proof; thus Taxpayer must establish that the pallet/scaffolding comes within IC § 6-2.5-5-40(b)(1): laboratory equipment; computer; computer software; telecommunications equipment; or testing equipment. Despite Taxpayer's assertion that the "scaffolding was specifically purchased for the sole purpose of facilitating the research and development activities of [Taxpayer]," Taxpayer has not shown that the pallet/scaffolding is exempt under IC § 6-2.5-5-40(b)(1). Additionally, the Department notes that Taxpayer has not established that the pallet/scaffolding was "acquired by the purchaser for the purpose of research and development activities devoted directly to experimental or laboratory research and development" under IC § 6-2.5-5-40(b)(3). Taxpayer's protest is denied.

(3) Temperature/Humidity Tracking and Trending:

Taxpayer describes this as a "computer-based system with accompanying temperature hardware that allows tracking and trending of temperature, humidity, and pressure differential in designated places throughout the facility." Taxpayer also states that it is "essential to the maintenance of the clinical product as it will quickly measure and communicate a warning if the actual temperature, humidity, pressure, etc. deviates from the required parameters." Taxpayer has not shown that this temperature/humidity tracking hardware is exempt—Taxpayer describes it as being used in "designated places throughout the facility," and as being "essential to the maintenance of the clinical product...." These uses do not come within the ambit of IC § 6-2.5-5-40(b)(1). Taxpayer has not established that the hardware was acquired for the purpose of research and development activities as required by IC § 6-2.5-5-40(b)(3). Instead it is used in the "maintenance of the clinical product" and to help "continually enhance the facility...." As noted supra, Taxpayer bears the burden of proof under IC § 6-8.1-5-1(c); exemption statutes are also strictly construed against the Taxpayer. Taxpayer's protest of this issue is denied.

(4) [J]scale conversion:

In its correspondence to the Department, Taxpayer states that the "[J]scale conversion was a fabrication done to the existing scales. The modification in effect built a shield to protect very small test product with very small weights from being affected by airflow in the room. This shield protects the product from either being removed from the scale entirely or by causing the precise scale to measure improperly." Taxpayer goes on to state, "This modification is key to the R & E process in that client requested measurements for materials must be precise in their use throughout the R & D process."

The Audit Report describes this item as a scale that "is being used in a room located in the warehouse to measure the weight of products when sending the products to a third party for testing." The Department again notes that Taxpayer bears the burden proof; despite Taxpayer's assertion that it is used "throughout the R & D process," Taxpayer has not established that the [J]scale is exempt under IC § 6-2.5-5-40(b)(1). Taxpayer's protest of this issue is denied.

FINDING

Taxpayer's protest of the walk-in-freezer is sustained subject to Audit verification of the following: that the freezer has not previously been used in Indiana for any purpose; and subject to Audit verification of the percentage that the freezer is used for "temperature excursion and thermal cycling stability studies." Taxpayer is denied regarding all other protested items.

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